

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See 86 Ill. Adm. Code 130.1935. (This is a GIL).

September 11, 2000

Dear Xxxxx:

This letter is in response to your letter dated July 19, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

I am conducting a survey to ensure that we are taxing correctly in all states. We are a retailer of dental supplies and equipment with salespeople and repair technicians located in all states. We also sell a software package to help the dentist automate their practice.

I would like a determination of the taxability of the following items, when purchased by a dentist for use in their practice.

On site training classes, billed separately from the software purchase.

Software technical support, which includes software updates, billed as a lump sum based on the length of the contract.

Telephone support, billed separately by the amount of time used, with no contract. The telephone support center is located in Illinois.

Custom programming, making changes to the software to customize it for a particular dentists practice. Billed based upon the complexity of the changes requested.

If there are any questions please contact me at #####.

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3). If the pre-written program or module was previously marketed, the new program will qualify as a custom program if the price of the pre-written program was 50% or less of the price of the new program. If the pre-written program was not previously marketed, the new program will qualify as a custom program if the charge made to the customer for custom programming services, as evidenced by the records of the seller, was more than 50% of the contract price to the consumer.

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer's duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);
- D) The vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and
- E) The customer must destroy or return all copies of the software to the vendor at the end of the license period.

As stated above, licenses of computer software are not taxable if they meet all of the criteria listed in Section 130.1935(a)(1). However, item (D) of that part requires the license to contain a provision requiring the vendor to provide another copy at minimal or no charge if the customer loses or damages the software. The Department has deemed software license agreements to have met this criteria if the agreements do not contain a provision about the loss or damage of the software, but the vendors' records reflect that they have a policy of providing copies of software at minimal or no cost if the customers lose or destroy the software.

Item (E) of this part also requires a license to require a customer to destroy or return all copies of the software to the vendor at the end of the license period. The Department has also deemed perpetual license agreements to qualify for this criteria even though no provision is included in the agreements that requires the return or the destruction of the software.

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail

transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3), enclosed.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Assuming that the services provided, such as installation, phone support, training, and seminars, do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

Retailers' Occupation Tax and Use Tax do not apply to receipts from sales of personal services. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred incident to sales of service. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

The purchase of tangible personal property that is transferred to service customers may result in either Service Occupation Tax liability or Use Tax liability for the servicemen, depending upon which tax base the servicemen choose to calculate their liability. Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on cost price if they are registered de minimis servicemen; or, (4) Use Tax on cost price if the servicemen are de minimis and are not otherwise required to be registered under the Retailers' Occupation Tax Act.

I hope this information is helpful. The Department of Revenue maintains a Web site, which can be accessed at [www.revenue.state.il.us](http://www.revenue.state.il.us). If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

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If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Martha P. Mote  
Associate Counsel

MPM:msk  
Enc.